SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1926

No. 394

C. G. LEWELLYN, COLLECTOR OF INTERNAL REVENUE FOR THE TWENTY-THIRD DISTRICT OF THE UNITED STATES, ETC., PETITIONER

VS.

ELECTRIC REDUCTION COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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[Captions omitted.]

In United States District Court for the Western District of Pennsylvania

ELECTRIC REDUCTION COMPANY, A CORPORATION organized and existing under the laws of the State of Delaware,
v.
C. G. LEWELLYN, COLLECTOR OF INTERNAL Revenue for the Twenty-third District of the United States in the Western District of Pennsylvania. } No. 3114 Law

S. Leo Ruslander and George K. Warn, for Plaintiff.
Walter Lyon and Warren H. Van Kirk, for Defendant.

Docket entries

Aug. 5, 1924. *Praecipe* for summons in assumpsit and statement of claim filed.

Aug. 5, 1924. Summons in assumpsit issued ret'ble 1st Mon. of Sept. next.

Aug. 6, 1924. Summons returned served with plaintiff's statement of claim on C. G. Lewellyn, by handing to and leaving a true and attested copy thereof with C. G. Lewellyn at Pittsburgh, Aug. 5, 1924.

Aug. 20, 1924. *Praecipe* for appearance of Walter Lyon and Warren H. Van Kirk for deft, filed.

Sept. 12, 1924. Affidavit of defense raising questions of law, filed & entered.

Mar. 23, 1925. Affidavit of defense filed; deft.'s requests for conclusions of lawful. (Jurat.)

Mar. 13, 1925. Order indorsed on argument list: " 1925, Mch. 13. Affidavit of defense raising questions of law withdrawn by consent of parties in open court with leave to file an affidavit of defense as to the merits and in the meantime the case to proceed to trial forthwith without a jury as tho an affidavit of defense had been filed. Same tried. Trial begun and concluded, C. A. V. Schoonmaker, J."

Mar. 13, 1925. Plaintiff's request for findings of fact and conclusions of law filed.

Mar. 25, 1925. Notes and transcript of testimony filed.

July 9, 1925. Opinion filed and entered directing judgment for defendant & noting exception to plaintiff.

July 9, 1925. Pursuant to the foregoing action of the court, judgment is hereby entered in favor of the defendant. J. Wood Clark, clerk.

Sept. 1, 1925. Petition of plaintiff for writ of error and order allowing same filed and entered.

Sept. 11, 1925. Petition & order filed and entered granting leave to file assignment of errors, *nunc pro tunc.*

7 Sept. 10, 1925. Assignment of errors filed.

Sept. 12, 1925. Bond *sur* writ of error approved & filed.

Sept. 12, 1925. Writ of error issued & Copy lodged in clerk's office.

Sept. 12, 1925. Citation awarded & issued and service accepted by Arnold M. Replogle, Ass't U. S. Atty.

Sept. 14, 1925. *Praecipe re* contents of record *sur* writ of error filed.

Sept. 14, 1925. Bill of exceptions, signed & sealed by the court.

[Praecipe for summons, Aug. 5, 1924, omitted in printing.]

5 In United States District Court

Statement of claim, filed Aug. 5, 1924.

The Electric Reduction Company, plaintiff above named, complains of C. G. Lewellyn, former collector of internal revenue for the twenty-third district of the United States in the Commonwealth of Pennsylvania, defendant above named, and says that said defendant is justly and legally indebted to plaintiff in the sum of $7,051.55, with interest upon $867.22 thereof from March 15, 1919, and upon $2,092.51 from June 15, 1919, and upon $2,045.91 from September 15, 1919, and upon $2,045.91 from December 15, 1919, upon a cause of action whereof the following is a statement:

1. The Electric Reduction Company, the above plaintiff, is a corporation duly organized under the laws of the State of Delaware. Its office and principal place of business is in Pittsburgh, Pennsylvania.

2. At the time of the payment of the tax as hereinafter set forth, C. G. Lewellyn, the above-named defendant, was collector of internal revenue for the United States of America for the twenty-third district in the Commonwealth of Pennsylvania, having been duly appointed and commissioned some time during the year 1913, and having served in this capacity as a duly qualified officer as aforesaid until about August 1, 1921, when he was succeeded by D. B. Heiner, Esquire.

3. The Electric Reduction Company, in compliance with the act of Congress of February 24, 1919 (known as the revenue act of 1918), duly filed its income and profits tax return for the year 1918, which return showed a tax liability of $8,183.63. Said tax was as

6 shown by true and correct copies of cancelled checks hereto attached, made part hereof, and marked "Exhibits 1, 2, 3, and 4," duly paid to C. G. Lewellyn, defendant, who was internal revenue collector at the times of said payments, as aforesaid, the said four payments totalling $8,184.33, or an overpayment of $.70.

4. Thereafter the Electric Reduction Company, on November 28, 1922, filed an amended income and profits tax return for the year

1918, said return showing a total tax liability for said year in the sum of $1,132.78. With said amended return the Electric Reduction Company filed a claim for refund in the sum of $7,050.85, being the difference between the tax liability shown on the amended return for 1918 and the tax liability shown on the original return for 1918, which was paid. A true and correct copy of said claim for refund, with said amended return as part thereof, is hereto attached, made part hereof, and marked "Exhibit 5."

5. The said amended return and said claim for refund were filed for the reason that the Electric Reduction Company suffered a deductible loss of $27,205.35 in 1918, which by error and mistake was not deducted as a loss for said year 1918 in the original return filed. The said loss occurred by reason of the facts as hereinafter set forth.

6. By writing dated July 2, 1918, and accepted July 3, 1918, the Electric Reduction Company entered into a contract with Konstantine Jouravleff, by which contract the said Konstantine Jouravleff agreed to deliver to said Electric Reduction Company one hundred fifty tons of tungsten ore sheelite to run over sixty per cent W. O. 3, deliveries to be made to said company's factory at Washington, Pennsylvania, in shipments of one car of thirty to thirty-five tons each month beginning August, 1918, through to the end of that
7 year; payments $24.00 per unit of one per cent of W. O. 3, the ton to be two thousand pounds. It was further agreed that the Electric Reduction Company should accept a draft for $30,000.00 in favor of said Jouravleff, payable in sixty days, to cover and to be deducted from the amount due from said company to said Konstantine Jouravleff of W. O. 3, which was to be shipped by said Jouravleff to said company in August, as aforesaid, and which would have a value of more than $30,000.00, and a like acceptance issued, if necessary, on the following cars. A true and correct copy of said contract is hereto annexed, made part hereof, and marked "Exhibit 6."

7. The said contract was negotiated through one Charles Hardy who acted as broker in the transaction. Prior to the making of said contract the said Konstantine Jouravleff was unknown to the plaintiff and plaintiff had had no previous business relations with him and he was brought to the attention of said company by the said Charles Hardy, who, to induce the plaintiff to enter into the said contract, falsely represented that said Jouravleff was a reputable business man of unquestioned integrity and financial responsibility and in a position to deliver tungsten ore in accordance with the said contract, and that he would vouch for him.

8. At the time of making said contract (Exhibit 6) and in order to induce the Electric Reduction Company to agree to the terms thereof and to give the acceptance provided for in said contract, the said Charles Hardy, in order to consummate the deal, at the request of the said company, undertook to keep said company fully informed concerning the deliveries of tungsten ore to be made by said Jouravleff under said agreement, which deliveries were to be made at a point distant from said company's place of business and

8 plant, and also concerning the progress said Jouravleff was making in mining and concentrating said tunsgten ore to be used in the fulfilling and performance of said contract, and to following up and seeing to the deliveries of tungsten ore by said Jouravleff.

9. After making said contract for delivery of tungsten ore and the making of said acceptance, the Electric Reduction Company performed the same on its part to be performed, and executed and delivered to said Jouravleff the acceptance referred to for $30,000.00. A true and correct copy of said acceptance is hereto annexed, made part hereof, and marked " Exhibit 7."

10. The said acceptance was given to the said Jouravleff on his written agreement that it was to cover and be deducted from the price of the first car of tungsten ore shipped, which car was to be shipped before the maturity of the trade acceptance on the 30th day of August, 1918, and with the understanding that the same was for material to be delivered by said Jouravleff to the plaintiff; and that if the said car was not shipped and delivered as agreed, the plaintiff was at liberty to refuse to pay said trade acceptance.

11. The said Charles Hardy had full knowledge of the terms and conditions under which said trade acceptance was given as hereinabove set forth.

12. John MacGregor Grant, Inc., was, at the time of the matters herein set forth, a corporation organized under the laws of the State of New York, engaged in the brokerage and banking business, had its principal place of business in New York City, and was a backer and promoter of the enterprise in which said Jouravleff was engaged.

9 13. The said John MacGregor Grant, Inc., had full knowledge of the agreement between the Electric Reduction Company and said Jouravleff, knew the conditions under which said acceptance was made, knew that the said Jouravleff failed to perform his contract and failed to deliver any tungsten ore, as required therein, and had not on August 30, 1918, delivered or shipped, or was in a position to deliver or ship, any car of tungsten ore, as required by said contract.

14. By mistake of the officers of the Electric Reduction Company, and contrary to the agreement as to the making thereof, the said acceptance (Exhibit 7) was made negotiable, and unconditional, instead of conditional with notice of its terms on its face.

15. The said John MacGregor Grant, Inc., with full knowledge of the facts, as before stated, and with full knowledge of the fact that the said Konstantine Jouravleff had not shipped or delivered, and was not able to ship or deliver any car of tungsten ore, as required by said contract (Exhibit 6), negotiated for the said Konstantine Jouravleff the said acceptance to other persons, without notice, from whom the said John MacGregor Grant, Inc., received the sum of $30,000.00.

16. The Electric Reduction Company thereafter and upon maturity, on August 30, 1918, duly paid the said acceptance to the holder thereof.

17. Subsequent to the making of said contract (Exhibit 6) and before the maturity of said acceptance (Exhibit 7), the Electric Reduction Company, from time to time, inquired of the said Charles Hardy concerning the progress that the said Konstantine Jouravleff was making in mining the said tungsten ore to be made by the said Jouravleff for said company under said contract, and the said
10 Charles Hardy, pursuant to the agreement which he had made with said company and the duties assumed by him in respect to said inquiries, promised to investigate said matters and to report thereon to said company.

18. The Electric Reduction Company was induced to pay said acceptance by receipt of a telegram from said Charles Hardy, and in reliance thereon. Said telegram is as follows:

AUGUST 29, 1918.

ELECTRIC REDUCTION COMPANY,
Washington, Pa.

Reference contract Jouravleff. Shipment, one car will be made today.

HARDY.

The information given in said telegram was false.

19. No part of the contract was ever carried out by the said Konstantine Jouravleff, except in December, 1918, the said Electric Reduction Company received from the said Jouravleff 56 bags containing 4,468.24 pounds of sheelite concentrates, in value amounting to $2,794.65, which sum was to be credited to the amount of $30,000.00, making a net loss of $27,205.35.

20. The Electric Reduction Company, from time to time, made efforts to obtain shipments of tungsten ore under the terms of said contract (Exhibit 6), or to obtain repayment of the said sum of $30,000.00, but no shipments were made thereon except 4,468.24 pounds in December, 1918, of a value of $2,794.65, which was applied on said acceptance, and left the loss thereon of $27,205.35.

21. On October 30, 1918, the Electric Reduction Company learned that the said Konstantine Jouravleff had never been and
11 would not be in a position to perform under his said contract; that the mining proposition by which the said Konstantine Jouravleff was to fulfill his contract with said company was that conducted by the Pine Creek Tungsten Company, in which the said Jouravleff had only a stock interest, but was not in control of said company nor of any of its property; that the mill and mines of said Pine Creek Tungsten Company were located near Bishop, Inyo County, California, and were in the development stage; the Electric Reduction Company later learned that the mines and mill of said Pine Creek Tungsten Company were in a development stage until in De-

cember, 1918; that said mill was not completed nor put into operation until in December, 1918, at which time from fourteen to sixteen tons of concentrates were produced by it and turned over to the Inyo County Bank, of Bishop, California, as security for money loaned by said bank; there was no other production of tungsten ore by said Pine Creek Tungsten Company in 1918.

22. Efforts were made by the Electric Reduction Company to recover its loss under said contract by bringing in March, 1919, three suits in the Supreme Court of the County of New York, State of New York; one against Konstantine Jouravleff; one against John MacGregor Grant, Inc., and one against Charles Hardy, the broker. Judgment was obtained against the said Konstantine Jouravleff, in 1919, in said suit against him. The judgment proved worthless as the said Jouravleff had no assets and disappeared. In 1921 the said suit against John MacGregor Grant, Inc., was discontinued as worthless as the defendant in that action had been adjudged bankrupt after the commencement of the suit. In the suit against Charles Hardy, the trial court on November 23, 1922, directed a verdict in favor of the defendant.

12 23. The Electric Reduction Company, by letter from the Commissioner of Internal Revenue, dated November 29, 1922, file reference IT:SA:AM:EG:264, was notified of a proposed additional assessment of income and profits taxes against it for the year 1918 in the sum of $3,774.51. A true and correct copy of said letter is hereto attached, made part hereof, and marked "Exhibit 8."

24. The Electric Reduction Company, by letter from the Commissioner of Internal Revenue, dated January 2, 1923, file number IT:SA:AM:EG:264, was advised that its claim for refund of $7,050.85 (Exhibit 5) was rejected. A true and correct copy of said letter is hereto attached, made part hereof, and marked "Exhibit 9."

25. The Electric Reduction Company, following the receipt of said letters (Exhibits 8 and 9) and within the time provided therefor, protested against the said proposed additional assessment of $3,774.51 and the rejection of its claim for refund of $7,050.85, and hearings were duly had thereon before the Income Tax Unit as provided by statute and Treasury Regulations.

26. Subsequent to said hearings, by letter from the Commissioner of Internal Revenue, dated March 13, 1923, the Electric Reduction Company was advised that its income, war, and excess profits taxes for the year 1918 were adjusted and its case closed on the basis of additional tax of $3,744.51. A true and correct copy of said letter is hereto attached, made part hereof, and marked "Exhibit 10."

27. Within the time provided by the revenue act and in accordance therewith and with the Treasury Regulations applying, the Electric Reduction Company duly appealed to the committee on ap-

13 peals and review, the body appointed by the Commissioner of Internal Revenue to hear and adjudge such cases, from the assessment of said additional tax of $3,774.51, and from the rejec-

tion of its claim for refund. A hearing was duly had thereon before said committee, and subsequently the Electric Reduction Company received a letter from the Treasury Department of the United States, dated April 17, 1923, file number IT:SA:AM:EG:264, rejecting its claim on said appeal and sustaining the Income Tax Unit in its conclusions. A true and correct copy of said letter is hereto attached, made part hereof, and marked "Exhibit 11."

28. Thereafter, on February 15, 1924, the Electric Reduction Company duly filed its claim for refund of said sums of $3,840.56 and $7,050.85, plus said overpayment of $.70, or a total of $10,892.11, taxes excessively and illegally demanded and collected. A true and correct copy of said claim for refund is hereto annexed, made part hereof, and marked "Exhibit 12."

29. By letter from the Commissioner of Internal Revenue dated August 1, 1924, file number IT:CR:C:CA, the Electric Reduction Company was advised that its said claim for refund was refused. A true and correct copy thereof is hereto attached, made part hereof, and marked "Exhibit 13."

30. The said acceptance (Exhibit 7) was made and delivered upon the strength of, and in reliance upon, the representations of the said Charles Hardy that the said Konstantine Jouravleff personally was in a position to and would deliver to said company before the maturity of said acceptance tungsten ore in such quantity to have a value in excess of the face of said acceptance, and the amount of said acceptance should be credited against said delivery, and
14 that the said Konstantine Jouravleff was in a position to and would otherwise fully perform under said contract, as set forth in paragraphs 7 and 8 hereof, whereas, in fact and in truth the said Konstantine Jouravleff was in a no position to ship the said tungsten ore in August, 1918, before the maturity of said acceptance, or at any other time; that the said Konstantine Jouravleff was not then or later the owner of any mines of tungsten, or otherwise, was not in a position to and did not control the output of any such mines, the mines of the Pine Creek Tungsten Company were not at any time in 1918 in a position to ship tungsten ore in quantities called for by said contract, all of which was well known to the said Konstantine Jouravleff, Charles Hardy, and John MacGregor Grant, Inc. That at all times during the year 1918 and thereafter said Jouravleff was financially irresponsible and a judgment recovered against him would have been uncollectible.

31. The said acceptance was negotiated by the said John MacGregor Grant, Inc., to innocent holders for value and with full knowledge of its conditional character and with full knowledge of Konstantine Jouravleff's being unable to perform said contract (as set forth in paragraphs 15 and 30 hereof); and said acceptance was duly paid at maturity through the false representations of the said Charles Hardy and in reliance thereon (as set forth in paragraph 18 hereof); with a resulting loss of $27,205.35, as stated in paragraph

20 above; the entire loss of $27,205.35 occurred in 1918, and resulted by reason of the giving, negotiating and paying said acceptance under the false representations of the said Charles Hardy and John MacGregor Grant, Inc., as hereinabove set forth. That during the year 1918 said John MacGregor Grant, Inc., was financially ir-
15 responsible and a judgment against it could not have been collected. That in 1918 the plaintiff had no legally enforceable claim against said Hardy as subsequently established by the suit entered. The defense of said Hardy was, specially, that the said allegel agreement between this plaintiff and the said Hardy constituted a special promise by said Hardy to answer for the debt, default, or miscarriage of another person, to wit, Konstantine Jouravleff; that said promise was not nor any note or memorandum thereof made in writing and subscribed by the said Hardy or by his lawful agent, and was void under the Statutes of Frauds.

32. The Electric Reduction Company is informed and believes, and therefore avers, that under the internal-revenue laws and Treasury Regulations said loss was a proper and lawful deduction against the income of said company for the year 1918, and that the collection of said amount of $7,051.55 as income and profits taxes due by the Electric Reduction Company for the year 1918, and being the excess of the amount shown by said amended return as being the tax due by said company for said year, was illegal.

33. The Electric Reduction Company is advised and believes, and therefore avers, that there existed no warrant in law for the collection, by the then said Commissioner of Internal Revenue, of the sum of $7,051.55 as corporation income and profits taxes due by the said company for the period ended December 31, 1918, herein complained of, under the provisions of the act of Congress of February 2, 1919; and that there existed no warrant in law for the refusal by the said Commissioner of Internal Revenue to refund said sum of $7,051.55, being the excess payment of tax made as aforesaid, in 1919.

16 34. That the collection by the then collector of internal revenue of the said sum of $7,051.55, being the excess of income tax lawfully due by the plaintiff for 1918, was unlawful and void, and without authority of law; and that there is therefore due from the defendant to the plaintiff the amount thereof, to wit, $7,051.55, with interest as aforesaid, for the recovery of which plaintiff brings this, its suit. That the amount sought to be recovered in this case is not the full $10,892.11 illegally collected because said sum was not all paid to defendant. A separate suit is being entered for the remaining $3,840.56.

S. Leo Ruslander,
Geo. K. Warn,
Attorneys for Plaintiff.

Duly sworn to by J. W. Weitzenkorn; jurat omitted in printing.

17 In United States District Court

Affidavit of C. G. Lewellyn, filed March 23, 1925

STATE OF PENNSYLVANIA,
County of Allegheny, ss:

C. G. Lewellyn, being duly sworn according to law, declares and says that he is the defendant in the above-entitled cause and that he has a just, true, complete, and legal defense to the whole of the plaintiff's claim of the character and nature as follows:

I

The averments of paragraph one of plaintiff's statement are admitted.

II

The averments of paragraph two of plaintiff's statement are admitted.

III

The averments of paragraph three of plaintiff's statement are admitted.

IV

The averments of paragraph four of plaintiff's statement are admitted.

V

With respect to the averments of paragraph five, the defendant admits that plaintiff filed an amended return and claim for refund for the reason that plaintiff claimed to have suffered a deductible loss of $27,205.35 in 1918, but defendant denies that plaintiff suffered a deductible loss of $27,205.35 during the year 1918, and denies that plaintiff committed either error or mistake in not claiming said amount as a deductible loss for said year 1918 in plaintiff's original return.

18

VI

The averments of paragraph six of plaintiff's statement are admitted.

VII

The averments of paragraph seven of plaintiff's statement are admitted.

VIII

The averments of paragraph eight of plaintiff's statement are admitted.

plaintiff filed its claim for refund in the amounts stated; but defendant denies that said taxes were excessively and illegally demanded and collected.

XXIX

The averments of paragraph twenty-nine of plaintiff's statement are admitted.

22

XXX

The averments of paragraph thirty of plaintiff's statement are admitted in so far as it is therein alleged that said acceptance was made and delivered by plaintiff upon the strength of, and in reliance upon, the representations of the said Charles Hardy, that the said Konstantine Jouravleff personally was in a position to and would deliver to said company before the maturity of said acceptance the tungsten ore in such quantity as to have a value in excess of the face of said acceptance, and that the amount of said acceptance would be charged against said delivery, and that the said Jouravleff was in a position to and would otherwise fully perform said contract. In so far as said paragraph 30 avers that the said Konstantine Jouravleff was in no position to ship the said tungsten ore in August, 1918, or at any other time; that the said Konstantine Jouravleff was not then or later the owner of any mine, of tungsten, or otherwise, was not in a position to and did not control the output of any such mines; the mines of the Pine Creek Tungsten Company, were not at any time in 1918 in a position to ship the tungsten ore in quantities called for by said contract, all of which was well known to the said Jouravleff, Charles Hardy, and John MacGregor Grant, Inc., and that at all times during the year 1918, and thereafter, said Jouravleff was financially irresponsible and that a judgment recovered against him would have been uncollectible, the same is denied.

XXXI

The averments of paragraph thirty-one of plaintiff's statement are admitted in so far as it is therein alleged that the said acceptance was negotiated by John MacGregor Grant, Inc., and
23 paid at maturity, and that Charles Hardy made false representations as set forth in paragraph eighteen of plaintiff's statement; and said paragraph is also admitted in so far as it is therein alleged that the said Charles Hardy set up the defense of the statute of frauds in the suit which was instituted by plaintiff against the Charles Hardy, and that the plaintiff did not recover a judgment against the said Hardy. The averments of paragraph thirty in so far as it is therein alleged that the said acceptance was negotiated to innocent holders for value and that the plaintiff suffered a loss of $27,205.35 in the year 1918 as a result of giving, negotiating, and paying said acceptance; and also in so far as it

is therein alleged that the said John MacGregor Grant, Inc., was financially irresponsible, and that a judgment against it in the year 1918 could not have been collected, are denied.

XXXII

The averments of paragraph thirty-two of plaintiff's statement are denied.

XXXIII

The averments of paragraph thirty-three of plaintiff's statement are denied.

XXXIV

The averments of paragraph thirty-four of plaintiff's statement in so far as it is therein alleged that the collection by the then collector of internal revenue of the sum of $7,051.55, for 1918, was unlawful and void and without authority of law, and that there is due the plaintiff the amount thereof, to wit, $7,051.55, with interest thereon, are denied. The averments of said paragraph thirty-
24 four in so far as it is therein alleged that a separate suit is being entered for $3,840.56, are admitted.

I, therefore, owe the plaintiff nothing.

All of the above stated facts are correct and true and defendant avers and expects upon the trial of this cause to be able to prove the same.

C. G. LEWELLYN.

Subscribed and sworn to before me this 23rd day of March, 1925.
[SEAL.]
A. M. KUSTES.
Dep. Clk. U. S. D. Court.

In United States District Court

Requests for findings of fact and conclusions of law ex parte plaintiff, filed March 13, 1925

The above entitled case having been tried upon stipulation of counsel that the testimony be heard and the case determined by the court without a jury, both parties waiving their respective rights to trial by a jury, plaintiff makes the following

Requests for findings of fact

1. Plaintiff paid out the $27,205.35, which is the basis of the claimed charge off as against 1918 income in the year 1918, and although plaintiff was diligent in seeking to recover said loss, was unsuccessful, and the total amount thus paid in 1918 was never, either in part or in while, recovered by plaintiff.

25 2. Aside from the legal question as to whether the loss was a "bad debt" or other "loss," as defined in the revenue act of 1918, it was sustained by plaintiff in the year 1918.

3. Plaintiff would not have paid the bill of exchange, Exhibit 7 attached to the plaintiff's statement, had it not relied upon misrepresentations of fact as to the shipment of a car of tungsten, the value of which would have been in excess of the $30,000.00 paid.

Requests for conclusions of law

1. The loss sustained by plaintiff falls within the provision of section 214-(a)-4 of the revenue act of 1918, which provides, "That in computing net income there shall be allowed as deductions * * * losses sustained during the taxable year * * * if incurred in trade or business."

2. Under all the evidence in this case, the judgment must be rendered in favor of the plaintiff.

Respectfully submitted,

S. LEO RUSLANDER,
Attorney for Plaintiff.

26 In United States District Court

Bill of exceptions, filed Sept. 14, 1925

Be it remembered that this cause coming on to be heard before Honorable F. P. Schoonmaker, district judge, all parties being represented by counsel, and plaintiff's statement of claim and defendant's affidavit of defence raising questions of law having been filed, the following order was endorsed on the argument list:

Minute entry

"1925, Mch. 13. Affidavit of defense raising questions of law withdrawn by consent of the parties in open court with leave to file an affidavit of defense as to the merits and in the meantime the case to proceed to trial forthwith without a jury as though an affidavit of defense had been filed. Same tried. Trial begun and concluded. C. A. V. Schoonmaker, J."

The parties, by their respective counsel, then and there entered into a stipulation of facts which is as follows:

Stipulation of facts

And now, to wit, March 13, 1925, it is hereby stipulated and agreed by and between counsel for the above-named parties that the above-entitled case may be considered and finally determined by the court upon the pleadings filed; and in any such determination and disposition the court shall take, as admitted, the following facts, viz:

1. The Electric Reduction Company, plaintiff, claims of C. G. ewellyn, former collector of internal revenue, the defendant, the sum of $7,051.55, with interest upon $867.22 thereof from
7 March 15, 1919, and upon $2,092.41 thereof from June 15, 1919, and upon $2,045.91 thereof from September 15, 1919, and pon $2,045.91 thereof from December 15, 1919, as additional cor- oration income tax which said amounts were paid to the defendant ollector on the respective dates set forth.

2. The Electric Reduction Company, the plaintiff, is a corporation luly organized under the laws of the State of Delaware, with its rincipal place of business in Pittsburgh, Pennsylvania.

3. C. G. Lewellyn, the defendant, at the times of payment of said ax of $7,051.55 was the collector of internal revenue for the twenty- hird district in the Commonwealth of Pennsylvania.

4. The Electric Reduction Company duly filed its income and rofits tax return for the year 1918, which showed a tax liability of $8,183.63, which said tax was duly paid to C. G. Lewellyn, the then ollector of internal revenue.

5. On or about November 29, 1922, the Electric Reduction Com- pany filed an amended income and profits tax return for the year 1918, showing a tax liability for said year of $1,132.78, and claiming a loss sustained for the year 1918 in the sum of $27,205.35 as is more particularly shown hereinafter. With said amended return it filed a claim for refund in the sum of $7,050.85, being the difference between the tax liability shown on the amended return for 1918 and the tax liability shown on the original return for 1918, which was paid. Said claim for refund was rejected by the commissioner by letter dated April 17, 1923, upon the ground that the loss was not finally and definitely determined to be a loss until 1922, and was not charged off as such until 1922.

28 6. The reason alleged by the Electric Reduction Company for the filing of the claim for refund and the amended return was that it claimed to have suffered a deductible loss of $27,205.35 in the year 1918, which was not deducted as a loss for said year 1918 in the original return filed.

7. The transaction on which said claim of loss is based was as follows:

8. The Electric Reduction Company entered into a contract with one Konstantine Jouravleff, dated July 2, 1918, and accepted July 3, 1918. Jouravleff therein agreed to deliver to the Electric Reduction Company one hundred fifty (150) tons of tungsten ore sheelite at said company's factory, Washington, Pennsylvania, in shipments of one car of 30 to 35 tons each month beginning August, 1918, through to the end of that year; payments $24.00 per unit. It is agreed that Exhibit 6 attached to plaintiff's statement is a true and correct copy of said contract. The Electric Reduction Company agreed to and did accept a trade acceptance for $30,000 in favor of said Jouravleff, payable in sixty days, to apply on and to be deducted

from the amount which would be due Jouravleff when he made the first shipment of ore. It is agreed that Exhibit 7 attached to plaintiff's statement is a true and correct copy of said trade acceptance.

9. Prior to the making of said contract Jouravleff was unknown to the Electric Reduction Company; he was introduced by one Charles Hardy, a broker handling ores, who, to induce the plaintiff to enter into the said contract, verbally represented that said Jouravleff was a reputable business man of unquestioned integrity and financial responsibility, and that he was in a position to deliver tungsten ore in accordance with said contract.

10. At the time of making the contract between Jouravleff and the Electric Reduction Company, and in order to induce said company to agree to the terms thereof and to give the acceptance provided for in said contract, the said Charles Hardy, at the request of the said company, verbally undertook to keep the said company fully informed concerning the deliveries of tungsten ore to be made by said Jouravleff under said contract, which deliveries were to be made at a point distant from said company's place of business and its plant, and also concerning the progress said Jouravleff was making in mining and concentrating the said tungsten ore to be used in the fulfilling and performance of said contract, as well as following up and seeing to the deliveries of said tungsten ore by said Jouravleff.

11. After the making of the contract between Jouravleff and the Electric Reduction Company, said company performed the same on its part to be performed, and executed and delivered to said Jouravleff the acceptance provided for in the contract for $30,000.00.

12. The said acceptance was given to Jouravleff with the agreement that it was to cover and be deducted from the price of the first car of tungsten ore to be shipped, which car was to be shipped before the maturity of the trade acceptance on August 30, 1918; and that if said car was not shipped and delivered as agreed, the plaintiff was at liberty to refuse to pay the said trade acceptance.

13. The said Charles Hardy had full knowledge of the terms and conditions under which said trade acceptance was given.

14. John MacGregor Grant, Inc., was, in 1918, a corporation organized under the laws of the State of New York, engaged in the brokerage and banking business, had its principal place of business in New York City, and was a backer and promoter of the enterprise in which Jouravleff was engaged.

15. The said trade acceptance for $30,000 was made negotiable and unconditional, and was placed before maturity with John MacGregor Grant, Inc.

16. John MacGregor Grant, Inc., with full knowledge of the facts, and with full knowledge of the fact that the said Jouravleff had not shipped or delivered, and was not able to ship or deliver any car of tungsten ore, as required by the contract between Jouravleff and the Electric Reduction Company, negotiated for the said Jouravleff the said acceptance to innocent holders, without notice, and received therefor the sum of $30,000.

17. The Electric Reduction Company duly paid the trade acceptance of $30,000 on August 30, 1918, at maturity, to the holder thereof.

18. Subsequent to the making of the contract between Jouravleff and the Electric Reduction Company, and before the maturity of said trade acceptance on August 30, 1918, the Electric Reduction Company, from time to time, inquired of Charles Hardy concerning the progress that the said Jouravleff was making in mining tungsten ore, and the said Hardy promised to investigate and report.

19. The Electric Reduction Company was induced to pay said trade acceptance by receipt of a telegram from Charles Hardy, and in reliance thereon. Said telegram is as follows:

"AUGUST 29, 1918.

ELECTRIC REDUCTION COMPANY,
Washington, Pa.

"Reference contract Jouravleff. Shipment one car will be made to-day.

"HARDY."

The information given in said telegram was false. No car was ever shipped.

20. The Electric Reduction Company, from time to time, made efforts to obtain from the said Jouravleff shipments of tungsten ore under the terms of the contract between them, and to obtain repayment of the said sum of $30,000.00, but no part of said contract was ever carried out by the said Jouravleff, except the said company received from Jouravleff in December, 1918, fifty-six (56) bags containing 4,468.24 pounds of sheelite concentrates (tungsten ore) of a value of $2,794.65, which amount the Electric Reduction Company applied on said trade acceptance of $30,000.

21. The Electric Reduction Company in March, 1919, brought three suits in the Supreme Court of the County of New York, State of New York; one against Konstantine Jouravleff; one against John MacGregor Grant, Inc., and one against Charles Hardy, the broker, to recover the said sum of $27,205.35. Judgment was obtained against the said Jouravleff in 1919, in said suit against him. The said judgment proved worthless as the said Jouravleff had no assets and had disappeared. In 1921 the said suit against John MacGregor Grant, Inc., was discontinued as worthless as the defendant in that action had been adjudged bankrupt after the commencement of the suit. In the suit against Charles Hardy the trial court, on November 23, 1922, directed a verdict against the therein plaintiff upon the special defense of Hardy that the alleged agreement between the Electric Reduction Company and him constituted a special promise by Hardy to answer for the debt, default or miscarriage of another person, and that said promise, note, or memorandum was not made in writing or subscribed by Hardy, and was void under the Statute of Frauds.

22. The Electric Reduction Company did not charge off the amount of $27,205.35 as a loss upon said trade acceptance until

[Indorsed on reverse side:] Pay to the order of John MacGregor Grant, Inc. K. Jouravleff.

Pay to the order of Hannevig and Company John MacGregor Grant, Inc. John M. Grant, president. Hannevig and Company, A. Statt, Lex. Hansen.

37 Pay to the order of any bank or trust company. Prior indorsements guaranteed, Jul. 25, 1918, Empire Trust Company, New York, N. Y. Byron L. Brown, secretary.

Pay to the order of any bank or trust company. All prior indorsements guaranteed, Girard National Bank, Phila. 8–13. Chas. M. Ashton, cashier.

$6.00 U. S. documentary stamps canceled.

PLAINTIFF'S EXHIBIT NO. 1

LOS ANGELES, CALIF., *Dec. 18, 1918.*

ELECTRIC REDN. CO.,
Washn., Pa.

In good faith I sent you yesterday's telegram and it proved again untrue, because not withstanding a gentleman's agreement the whole thing has been taken out of my hands and placed in full control of a Bishop banker. To-day when I was getting ready to go east they placed before me the alternative of my surrendering the control or closing down the business and time for answer given seven hours. Please send at once your representative to act quickly. I am still holding stock in the company and have a contract for concentrate and claims against other big stockholders. I am placing myself at your full disposal and will cooperate with you in any way and have wired New York placing at your disposal for payment my in-

38 terest in Baltimore tungsten smelting plant. The business here is a good one but is in the hands of unreliable and incompetent men.

JOURAVLEFF.

During the course of said trial the court made certain rulings rejecting evidence offered by the plaintiff and in each instance counsel for plaintiff duly excepted thereto; counsel for defendant offered no testimony; at the conclusion of the trial counsel for plaintiff submitted to the court requests for findings of fact and conclusions of law, no specific answers being given thereto.

Minute entries

On March 23, 1925, an affidavit of defense as to the merits was filed.

Thereafter the court on July 9, 1925, filed an opinion in which the clerk was directed to enter judgment for defendant and due exception noted to plaintiff, and on the same day judgment was accordingly so entered.

On September 1, 1925, petition was presented by the plaintiff for a writ of error and citation, and order made the same day allowing same and fixing bond in the sum of $500.00 as security for costs, and assignment of errors filed.

Assignments of error

First exception. The learned court erred in rendering and entering judgment for defendant, as contained in the opinion of the court filed July 9, 1925, and the entry made thereon as follows:

"Judgment may be entered in this case in favor of defendant and due exception noted to the plaintiff.

39 "July 9, 1925. Pursuant to the foregoing action of the court, judgment is hereby entered in favor of the defendant."

Second exception. The learned court erred in refusing judgment for the plaintiff against the defendant.

Third exception. The learned court erred in ruling as a matter of law that under the facts as found by the court the plaintiff is not entitled to recover, which ruling is contained in the opinion of the court as follows:

"On this state of facts we find as a matter of law that the plaintiff is not entitled to recover."

Fourth exception. The learned court erred in its opinion in ruling as follows:

"The transaction involved is one of debt falling within the provisions of section 234(a) (5) of the revenue act of 1918, hereinbefore quoted."

Fifth exception. The learned court erred in not ruling, as requested, that the transaction involved resulted in a loss to plaintiff within the provisions of section 234(a) (4) of the revenue act of 1918, which request was as follows:

"The loss sustained by plaintiff falls within the provisions of section 214(a) (4) of the revenue act of 1918, which provides: 'That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

"'* * * Losses sustained during the taxable year and not compensated for by insurance or otherwise * * * if incurred in trade or business.'"

40 Sixth exception. The learned court erred in holding the loss was by reason of a bad debt as set out in the following portion of its opinion:

"* * * plaintiff lost the money it paid Jouravleff on account of the purchase price of ore, but that loss arose out of a bad debt, which to be claimed as a deduction from income must be charged off during the taxable year. This was not done. The plaintiff cannot recover."

Seventh exception. The learned court erred in rejecting the plaintiff's offer of evidence, as follows:

Plaintiff's witness, William H. Weis, being on the stand, the following offer and ruling occurred (Transcript, pp. 17–19):

Mr. RUSLANDER:

Q. When did the Electric Reduction Company cease to transact business?

A. July 1st, 1920.

Q. Did it at any time after 1918, have sufficient income to absorb the loss on this Jouravleff transaction?

Mr. BLAISDELL. Defendant objects, as being entirely immaterial, incompetent, and irrelevant to any issue in this case. This simply refers to the reduction of loss in 1918.

The COURT. We do not see that this is material.

Mr. RUSLANDER. I will make an offer. Counsel for plaintiff offer to prove by the witness on the stand that unless the loss as alleged is against income in the year 1918, the plaintiff will not have the benefit of it, because it ceased to continue its business and
41 earning an income prior to the termination of the suits in 1922, and its income in 1919, 1920, and 1921 was so small that it would not have absorbed any appreciable amount of the loss. This for the purpose of arguing that under the law and regulations which fix losses as against income, the plaintiff could not have sustained a loss of this character in the years subsequent to 1918, especially after they had ceased to do business.

Mr. BLAISDELL. Defendant objects to the offer, for the reason that it is immaterial, irrelevant, and incompetent, and can not properly affect any issue in this case, the only issue in this case being whether or not a certain item was a proper deduction for the year 1918.

The COURT. In view of the fact that the only issue in this case is whether or not the plaintiff is entitled to claim the item in issue here as a deductible loss in 1918, we can not see that it is at all material to inquire into the incomes of the plaintiff under the years succeeding 1918. That would apparently have no bearing upon the issue in this case. For that reason, we sustain the objection and note an exception to the plaintiff."

Eighth exception. The learned court erred in rejecting the plaintiff's offer of evidence, as follows:

Plaintiff's witness, William H. Weis, being on the stand, the following offer and ruling occurred (Transcript, pp. 21–24):

42 Mr. RUSLANDER:

Q. Is an account receivable a definitely known term in accounting?

A. As I understand the term——

Q. Just answer the question whether or not it is.

A. Yes.

Mr. RUSLANDER. Counsel for plaintiff desires to ask the witness questions as an expert, and before doing so offers the counsel for the defendant the opportunity to cross-examine as to his qualifications.

Mr. BLAISDELL. I do not care to cross-examine the witness as to his competency, but I propose to object to what I think is coming. I would suggest you make an offer.

Mr. RUSLANDER. Counsel for plaintiff offer to prove by the witness as a qualified and experienced accountant, the following: that there is a distinction between the accounting method of handling a loss and carrying an accounts receivable; that an accounts receivable, as it is ordinarily understood, means credit extended to a customer, or money loaned, or an account that arises in the usual course of business in which (credit) extended to the debtor is the determining factor; that advance payments for merchandise, or losses by obtaining merchandise under false pretense or by conspiracy, or other cases of that character where there is no factor as to granting credit to the person who receives the money or merchandise, are not regarded as accounts receivable, but as transactions which represent losses. Further, that the transaction in question being the
43 payment of the money to Jouravleff upon the false representation that the car of ore was already shipped, would not constitute a transaction that should be properly carried as an accounts receivable, but one which should be carried on the books as showing a loss, as distinguished from a purely accounts receivable or bad debt.

Mr. BLAISDELL. To this offer the defendant objects, for the reason that the same is entirely immaterial and incompetent, and can not tend to prove or disprove any issue in this case. The statement of facts herein admitted, supplemented by the testimony of this witness, shows that the item in question, the amount of money, $30,000, was charged to Jouravleff as an advance payment on ore. The statement of facts also shows that it was carried as a bills receivable item upon the books of the plaintiff. In view of these facts, I can not see any relevancy for an expert dissertation upon accounting.

The COURT. Apparently under the statute the taxable is entitled to charge off losses sustained during the taxable year and ascertained to be bad debts. It is impossible for us to see how—whether the accounting profession, expert accountants, regard such transactions as accounts receivable or not—has any bearing upon the issue raised by the statute here. We have to determine, first, whether the loss claimed is a loss which occurred in the fiscal year 1918, or whether it is a bad debt, as described by the statute at that time. Now, what the practice of accountants may be with reference to the book entries of transactions, we think would have no value whatever in
44 arriving at any determination upon the issues here. For that reason, we sustain the objection and note an exception to plaintiff.

NINTH EXCEPTION. The learned court erred in sustaining defendant's objection to the question of plaintiff's counsel, and in rejecting the testimony as follows:

Plaintiff's witness, William H. Weis, being on the stand, and having been qualified as an expert accountant of twenty-five years' experience, after plaintiff's offer as set forth in Exception No. 8 herein had been rejected, was asked the following question and upon objection of defendant's counsel thereto, the following ruling was made (Transcript, pp. 24–25):

Mr. RUSLANDER:

Q. State whether or not this transaction with Jouravleff was one which accountants would consider a bad debt, as distinguished from a loss.

Mr. BLAISDELL. To that we urge the same objections as heretofore urged to the offer of proof.

The COURT. We sustain this objection. We can not see that the opinion of this witness as an expert accountant, would have any value in ascertaining whether or not the item in question in this case comes within purview of the statute as to deductible losses or bad debts. We therefore sustain the objection and note an exception to the plaintiff.

TENTH EXCEPTION. The learned court erred in sustained defendant's objection to the admission in evidence of a telegram and rejecting it, as follows:

45 Plaintiff's witness, Clifton Taylor, being on the stand, after having identified as an original a telegram from Jouravleff to the plaintiff dated December 18, 1918, which was admitted in evidence (Plaintiff's Exhibit No. 1) and which contained a statement to the effect that the whole thing (meaning Pine Creek Tungsten Company, from the mines of which company Jouravleff expected to receive the ore with which to fulfill his contract with the plaintiff) had been taken out of his (Jouravleff's hands and placed in full control of a Bishop (California) banker, identified in similar manner as an original the following telegram (Plaintiff's Exhibit No. 2) dated December 22, 1918, from W. W. Watterson, president of the Inyo County Bank of Bishop, California, to the plaintiff:

LOS ANGELES, CALIF., *Dec. 22, 1918.*

ELECTRIC REDN. CO.,
Washn., Pa.

We are contemplating taking controlling interest in Pinecreek Tungsten Company owing to their getting in financial straits. Would like information relative Jouravleff contract with you what is tonnage price and terms and will deliver up to May or June.

Be acceptable if winter shuts off production. In addition this tonnage can you make firm offer for thirty tons sheetlite monthly say to December. Please wire answer here Los Angeles to-morrow forenoon if possible, care Angelus Hotel.

W. W. WATTERSON.
President Inyo County Bank, Bishop, Calif.

Whereupon the court sustained defendant's objection to the
46 offer of said telegram in evidence, as follows (Transcript, pp. 37–40):

Mr. RUSLANDER. Plaintiff's Exhibit No. 2 is offered in evidence.

Mr. BLAISDELL. Defendant objects to plaintiff's offered Exhibit No. 2 for the reason that it purports to have been received from some person who was an entire stranger to the contractual parties in this case; that is, it was not from Jouravleff, or any person associated

with him, apparently, and that the same is entirely incompetent, irrelevant, and immaterial, and can not tend to prove or disprove any issue in this case.

The COURT. We can not see what bearing this telegram would have on the issues here and how it would be proof of anything at all, so far as the issues here are concerned.

Mr. RUSLANDER. I overlooked a connecting link.

Q. Exhibit No. 1 speaks of the Pine Creek Tungsten Company getting into financial straits. Can you state whether or not Mr. Jouravleff was connected with this company in 1918?

A. Yes, sir; he was.

Q. Can you tell whether or not this was the company from which Jouravleff was to get the ore that was to be delivered to the Electric Reduction Company?

A. He was.

Q. Can you tell us whether or not this was the only place that Jouravleff could get this ore at that time?

Mr. BLAISDELL. Objected to, for the reason that it is incompetent, irrelevant, and immaterial to any issue in this case, and it
47 would be manifestly beyond the power of this witness to testify unless it be shown that he is so qualified.

The COURT. Yes; he would have to know what the capacities of Jouravleff were in the matter of securing ore. It does not appear that he is competent to answer that question.

Mr. RUSLANDER:

Q. Can you tell us whether or not this was the place where Jouravleff was stationed when he sent the telegram, Exhibit No. 1?

A. Yes, sir.

Q. Can you tell us whether or not this mine from which he was to ship ore, was the Pine Creek Tungsten Company's mine?

A. Yes.

Mr. BLAISDELL. I move to strike that out. There is no proper foundation shown that this witness is qualified to testify as to where Mr. Jouravleff was to get his ore, or what were Mr. Jouravleff's limits as to the possibilities of obtaining ore, or where he was stationed.

The COURT. Yes; this must be stricken out. We can not see how a statement by this man who signed himself as president of this Inyo County-Bishop Bank of California, would be evidence that could properly sustain a finding that Jouravleff was financially or otherwise unable of making delivery of ore as contracted for. Persons actually familiar with Jouravleff's financial responsibility and capacity and his power to deliver ore might properly be called to testify, but this witness merely inquiring of others, could not bring here the reports that they made to him, as competent testi-
48 mony. If a man's reputation as to financial responsibility in carrying out a contract, is to be testified to, it must be by witnesses who are familiar with him and his capacity to carry out